FINANCIAL LEGISLATION.

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THE limitations of our National banking system and the objectionable features of the Government's fiscal system have been conspicuously displayed in recent weeks. With a panicky money-market here, conditions abroad have been such that no help could be had there, and our banks of issue have been powerless to give any relief. As the Government's revenues have been exceeding its expenditures to the extent of several million dollars a month, the Treasury was automatically locking up money at that rate until Secretary Cortelyou, in the exercise of a wise discretion, counteracted its operations by increasing deposits in banks. In other words, he intervened to avert the mischief which the regular Treasury operations, uncorrected, would have caused. The provisions of law under which the Secretary is obliged to act to do this are so vague and imperfect as to impose most undesirable responsibilities upon him and barely permit of successful administration.

The financial legislation passed by Congress at the late session is not likely to change materially the relations of the Treasury to the money-market or the practice of the National banks in the issue and retirement of their notes. The provision allowing the Secretary of the Treasury to deposit customs receipts in National banks wipes out a bookkeeping distinction between customs revenues and receipts from other sources. The distinction originated during the suspension of specie payments, when gold only was receivable for customs and was required to be held in the Treasury to meet payments upon the public debt. No reason for segregating these funds now exists. So long, however, as the Sub-Treasury system is maintained it is to be presumed that the Treasury will keep only its surplus in banks, and the surplus

never equals the internal revenue receipts, which have always been available for deposit. To place all the Treasury collections in banks and make the current disbursements from the banks is perhaps allowable under the law, but the money-market would gain but little in available funds over the amount of the surplus, and the troublesome detail of security would be considerably more vexatious.

The provision which enlarges from \$3,000,000 to \$9,000,000 the amount of notes which a National bank may retire in one month is designed to promote elasticity in bank circulation. Under a system of note issues such as the countries of Europe generally have, a tight money-market will draw out new issues and a relaxation of demand will retire them, but our system is too clumsy and unresponsive for such automatic action. With us a bank desiring to increase its issues must deposit Government bonds at the Treasury and order notes printed, which will take four to six months of time. Heretofore, when it desired to retire circulation it had to file notice of its intention and await its turn until at the rate of \$3,000,000 a month its application was reached. The amendment now made seeks to encourage the taking out of temporary circulation by facilitating its retirement. A bond-secured circulation is, however, hopelessly unresponsive to business needs, because it is influenced more by the price of bonds than by current interest rates. An issue of notes upon security of this kind does not ordinarily increase a bank's supply of cash. The bonds being worth a premium, it will lose more cash in providing the security than it gets as the result of the transaction. The only way a bank can increase its cash resources under the note-issuing privilege is by borrowing the bonds. Our law has only one end in view, and that is security. To accomplish this a National bank is required to make an investment entirely outside the field of commercial banking, and its note issues are so related to the market price of bonds that the true function of such issues, which is to effect an economy in the handling of the country's exchanges, is entirely lost sight of.

The provision of the Aldrich act which authorizes the reissue of United States notes in ones, twos and fives, and of gold certificates in tens, is an extension of the policy, inaugurated by the act of March 14th, 1900, of reducing the Government credit notes to small bills. Under the act of 1900 the amount of silver

certificates in ones, twos and fives has increased from $181,386,093 on February 28th, 1900, to $446,746,069 on February 28th, 1907, and at the last date the total of outstanding silver certificates in denominations above ten dollars was only $25,226,931. These certificates have been thus scattered and engaged in the retail trade and can never again be a menace to the Treasury. The Aldrich act will dispose of the legal-tender notes in the same way. Eventually all the Government's credit notes may be reduced to the one-dollar size, and by restricting the legal-tender power of that denomination to payments of, say, $100, the Secretary of the Treasury may be authorized to issue and redeem them to satisfy all demands, as in the case of the subsidiary coins. Then the $150,000,000 reserve fund in gold and the entire reserve of silver coin can be dispensed with and become general assets of the Treasury. The aggregate value of these two funds, counting the silver at its bullion value, would be $400,000,000 to $500,000,000. Thus we may easily grow out of two great problems which have complicated our politics, to wit: how to dispose of the greenbacks, and what to do with the overvalued silver dollar.

The main problems connected with our monetary and fiscal systems are not disposed of by the Aldrich act. We still have no resource in a financial emergency except the importation of gold. We still have the cumbersome Sub-Treasury system (except as modified by the Secretary's authority to make deposits in banks) likened by Daniel Webster to the fiscal system of Darius, King of Persia. We still take our chances that the Secretary of the Treasury, whoever in the future he may be, will voluntarily correct the mischievous effects of the Independent Treasury by judicious use of the banks. We still compel the Secretary to bear the responsibility of selecting the banks in which deposits shall be made, and of determining how much each bank shall have and what the security shall be, although these duties inevitably involve him in the most disagreeable kind of criticism a public official is called upon to endure. Seven years ago there were about 250 depositories; now there are 1,225, and with 6,411 National banks in the country the task of distribution has only begun. It is just getting to be known that public deposits are to be had by energetic solicitation, and Senators and Congressmen in all parts of the country are under pressure to help secure

these favors. This pressure comes from an influential class of their constituents, and the Secretary of the Treasury is directly subjected to it by a provision of the Aldrich act, instructing him to "distribute the deposits herein provided for equitably as far as possible between the different States and sections." Under this mandate there is no reason why every National bank may not claim a share. Besides the profit from the deposits the prestige of being selected as a National depository makes the designation desirable, and if one bank in a neighborhood is able to advertise this mark of confidence its competitors all want to be placed on an equality with it. The task of arranging such a distribution, and looking after the security, if the scarcity of Government bonds requires the acceptance of other securities, is an intolerable if not impossible one. Imagine the situation when it becomes necessary to reduce deposits and the Secretary must select the banks to be dropped!

The operations of the Treasury are growing in magnitude every year, and the difficulties inherent in present methods become correspondingly greater every year. Receipts and disbursements are each approaching $1,000,000,000 a year. If this vast sum flowed through the Treasury in a steady stream, its management would be a comparatively simple matter; but the greater its volume the greater are the possible fluctuations and possible differences between receipts and disbursements, and the consequent difficulties in managing the surplus.

The people of nearly every other important commercial country of the world have worked these problems out to their satisfaction, and it is a significant fact that they have all come to practically the same system. The French have entrusted to the Bank of France, a semi-official institution, with a capital of 182,500,000 francs, these functions, which they have deemed it impracticable for the Minister of Finance to discharge; and the management of French finance has been the admiration of the world. The Germans are as hard-headed in business affairs as any people in the world, and they have entrusted these functions to the Imperial Bank of Germany, with a capital of 180,000,000 marks, of which the Chancellor of the Empire is the official head. The Japanese are recognized as thorough in whatever they undertake. They copied our system of national banks in 1872, providing circulating notes based on deposits of Government

bonds; but they have since established the Bank of Japan, modelled after the Imperial Bank of Germany, and made it the only bank of issue and the agency through which the Government conducts its fiscal operations. Russia, Austria-Hungary, Italy, Spain, the Netherlands and all other European countries manage their fiscal affairs in a similar manner. The services of the Bank of England to the British Government are well understood, but its system of note issues is generally recognized as inferior to that of the Imperial Bank of Germany. These great semi-official institutions, by which other Governments correlate their Treasuries to the business world, are performing their functions satisfactorily. Why may we not profit by their experience?

Whenever a great central banking institution is proposed for the United States, the common response is that we tried it once, and hence it is useless to make another effort. It is said that such an institution is an appropriate agency for a monarchy, but out of place in a republic—that it would be controlled by Wall Street or drawn into politics, and that it would be antagonistic to our system of independent banks.

To the first argument, the answer is that the task of handling the Treasury finances is not necessarily different under a republic from what it is under an empire. It is quite as injurious to business in a republic to have large sums withdrawn from circulation and locked up in a Treasury vault as it would be in an empire, and even more difficult for the Secretary of the Treasury of the United States to distribute this money in bank deposits than it would be for the Minister of Finance of Russia to do it. Furthermore, the tendency to organization and centralization in industry and finance is not peculiar to monarchies, but in the degree in which it gives higher efficiency it is quite inevitable in republics, and the question is not whether there shall be centralization in banking, but whether it shall be directed and controlled by the Government. Unification and centralization are going on in financial circles now, and to an extent perhaps not fully appreciated. The great banks of New York, with their connections, are more powerful relatively now than they would be with a central banking institution dominated by the Government and organized as outlined below.

It is apparent, however, that a central bank for the United States would have to be organized now on a somewhat different

plan from the old United States Bank or any of the foreign banks. Our existing banking institutions, State and National, should not and need not be antagonized or interfered with. On the contrary, they should be used as integral factors in the new system. The central institution should be a bank for bankers only, and its stock should be placed entirely with the National and State banks of the country. Suppose the new institution to have a capital of, say, $50,000,000, the shares to be apportioned to State and National banks on the basis of their capital. Let this institution take over all the funds of the Treasury, except the $150,-000,000 reserve and the coin held against certificates. Give it authority to issue notes to the amount of, say, $100,000,000, and more under the tax provision of the Imperial Bank of Germany. Establish a branch office in every city where there is now a Sub-Treasury and in other important centres—at least one in each State. Turn over the functions of the Sub-Treasuries to this institution, and have it handle the receipts and disbursements as the central banks abroad do for their Governments. Confine its lending operations to re-discounts of short-time paper for its own stockholders.

Such a bank must be so organized that control cannot pass to a few, or to one locality, and the Treasury Department should be able to control its general policy. There should be such a division of authority that, while the Government might shape the general policy, the details of management, the placing of loans, the selection of employees, etc., would be in the hands of officials representing the stockholders. Such a division of authority between the State and the stockholders is not experimental. It is a feature of the two greatest banking institutions of the world, the Bank of France and the Imperial Bank of Germany. A brief sketch of the organization and relations to the Government of these two institutions will be instructive in this connection.

The capital of the Bank of France is paid in by private shareholders, who are represented in the management by a Board of Regents, of fifteen members, of whom three must be Treasury officials, and by three Censors. The former correspond to an ordinary board of directors. The Censors are, as the name would indicate, inspectors or auditors. They are independent of the official staff appointed to watch over the execution of the laws and regulations and give an account of such supervision to the

stockholders. The executive officers of the Bank are a Governor and two assistants called Under-Governors, all of whom are appointed by the President of France. No paper can be discounted unless approved by the Governor and also by a Discount Committee of the Regents. The Bank is required by law to have at least one branch in every Department of France. The Director of each branch is appointed by the President of the Republic from among three, whose names are submitted by the Governor of the Bank. Each Director is assisted by an Administration Council composed of six to twelve members, who are appointed by the Governor from a list of double the number presented by the Board of Regents. There are also three Censors for each branch, chosen directly by the Regents. The executive staff of the Bank, among whom are a Secretary-General, Comptroller-General and Chief Cashier, is appointed by the Governor. The Bank, at the last renewal of its charter, which occurred in 1897, in return for its privileges agreed to loan the Republic 180,000,000 francs for the term of the Charter, without interest, to pay a tax on its productive circulation equal to one-eighth of one per cent. of the discount rate, and, whenever the discount is above five per cent., to pay three-fourths of the excess into the public Treasury. The present legal limit of the Bank's circulation is 5,800,000,000 francs, but the limit is constantly being raised.

The capital of the Imperial Bank of Germany, like that of the Bank of France, is all supplied by private shareholders. The authority of the Government is exercised by a Board of Directors, appointed by the Emperor, at the head of which is the Chancellor, or Prime Minister, of the Empire. His acting representative is the responsible manager of the Bank. None of these officers may own stock in the Bank. The stockholders are represented by a Central Committee of fifteen members, which assembles at least once a month. This committee reviews the conduct of the Bank, makes recommendations and looks after the interests of the shareholders generally. The continuous and special oversight in the interest of the shareholders is exercised by a special committee of three, chosen from the Central Committee, and known as Deputies. These Deputies are authorized to attend all meetings of the Imperial Board, with advisory votes, and are expected to be present during business hours and take cognizance of the routine business, inspect the books, audit the accounts, have knowl-

edge of the cash, etc. The profits of the Bank are divided between the shareholders and the Imperial Treasury as follows: First, three and one-half per cent. to the shareholders; of all additional profits, one-quarter to shareholders and three-quarters to the Treasury. There is no legal limitation upon the note circulation of the Bank, except the provision that one-third of its circulation must be covered by coin and bullion, and that a tax of five per cent. must be paid upon all issues above a certain limit, which has been raised from time to time.

These institutions provide the machinery through which the Treasury Departments of France and Germany perform their appropriate functions with relation to the public funds and the supervision of the circulating medium. They are properly dual in management, because on the one side they have official responsibilities, while on the other they enter directly into the business life of these countries. Through them, the Governments come into closer and more practical relations with the business world than they could in any other way. The scheme is in no sense an experiment. In both countries it is an unquestioned success. The fact that the plan has been almost universally copied affords the strongest possible endorsement of it. The influence of the shareholders, who furnish the capital, is naturally for a practical and efficient administration, while the authority of the state is exercised under a sense of responsibility to the whole country and subordinates the idea of profit to public service. This combination of private interest and public authority affords the system of checks and balances which should accompany all grants of power.

A central bank for this country which served only as a connecting link between the Treasury and existing State and National banks would not hold the commanding position of the two institutions described, but the general plan upon which they are organized suggests how most of the objections to such an institution could be met. Suppose its stock to be held by National and State banks in proportion to their capitalization; allow the stockholders to select a Board of Directors, similar to the Board of Regents of the Bank of France, but let them be elected by territorial districts, so that every part of the country would be represented in proportion to its holdings; create an executive board of, say, five, of which the Secretary of the Treasury, the Comptroller of the Currency and the Treasurer of the United States

would be three, the other two to be chosen by the Directors, the executive board to determine the general policy of the Bank; let the executive officers be named by the Secretary of the Treasury from a list submitted by the Board of Directors; require the bank to have at least one office in every State, and let the stockholders within a defined territory tributary to each branch select an advisory board for that office, and submit a list of names from which the manager should be appointed; let a corps of inspectors or auditors be appointed, in part by the Secretary of the Treasury, and in part by the Board of Directors, to examine all offices at frequent intervals.

Could such an institution become an offensive monopoly or fall under the control of any locality? Would the danger of its being drawn into politics be greater than the danger of the Treasury being drawn into politics under the present system? Through its branches the funds belonging to the Treasury which its was desirable to have returned to circulation could be placed by loan in any part of the country, and wherever placed the profits would belong to all the stockholders subject to any division with the Treasury that might be provided for. The loans should be rediscounts, restricted to short-time paper arising from the movement of staple commodities to market, and being constantly liquidated.

Through the funds under its control and the note-issuing power given it, the central institution would be able to come to the aid of any bank in the system, provided such bank was worthy of assistance. No sound banking institution in the system need ever fail after the central bank was established. The weakness of our banking system to-day is in the isolation of the individual units. When a real crisis comes, the situation is likely to be aggravated by the efforts of individual banks to strengthen themselves, and by the failure of the unprepared. An effort is made in the cities to remedy this isolation by cooperation through the clearing-house associations, and the benefits of closer relations in time of stress have been experienced repeatedly. The central institution would be a bond of union for both State and National systems, and would virtually place the resources of the Government behind them whenever the public welfare was concerned. The existing banks would not be disturbed, but they would be federated for certain purposes. If the profits of the central institution were

divided with the Treasury, after the plan of the Imperial Bank of Germany, the returns upon the stock would not be large, but the security afforded to every bank in the system would make it an object for each to take its quota.

Finally, the note-issuing power vested in the central bank would give this country a degree of independence of conditions abroad which it does not now have. For weeks lately, the price of foreign exchange has been such that gold importations could have been made with profit; but they have not been made, although money was badly needed in New York, because the withdrawal of gold from foreign markets would create a disturbance which might react disastrously in New York. Six months ago, notice was virtually served on New York bankers that the taking of gold from London at that time would be regarded as an unfriendly act. An untoward event abroad which would create a demand for ready money might at any time cause the return of such quantities of American securities as to occasion gold exports from New York, and there is no assurance that such demands will consult our convenience. They might fall imperatively upon a situation already strained to the limit. During the last two years there has existed the possibility of a collapse of Russian securities which would force liquidation in every market of Europe. This country needs the machinery by which its credit could be used in such an emergency and its industrial interests shielded from the blow. With the notes of such an institution to temporarily take the place of gold in the domestic exchanges, these international demands could be met and the situation adjusted to them. The note circulation, with its elastic possibilities, would be a buffer or cushion to ease the shock. The difference between ability to satisfy all legitimate needs, at even a high rate of interest, and inability to meet such demands at all, is the difference between gradual adjustment and industrial collapse.

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